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Daniel Weintraub: It's time for the governor to fix budget for good

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California's perpetual budget mess made the news again last week. Elizabeth Hill, the state's nonpartisan legislative analyst, offered another gloomy projection: a \$10 billion shortfall next year between the tax revenue coming in and the spending required by current law. If nothing is done to close that gap, Hill said, a similar chasm will open a year after that.

The end of the housing boom, a lull in the stock market and a slowdown in the growth of corporate profits have dented tax payments. On the spending side, meanwhile, the state's laws require increases for education, health care, public assistance and prisons, even if there is not enough money in the treasury to pay for them.

That's definitely a problem. Ten billion dollars is more than California spends in a year on its prisons, or on the University of California and the California State University systems combined.

But that wasn't news. Anyone who has been following the state's fiscal condition already knew that Gov. Arnold Schwarzenegger and the Legislature would be facing a tough situation next year. They will have to cut services or find new revenue, or both, to make it work.

I was more intrigued by a piece of the analyst's report that didn't show up in any of the headlines. And it was actually a bit of cheery news in an otherwise bleak forecast.

If current projections hold, Hill said, three years from now the state's shortfall will dramatically decline, all by itself, and by the end of the five-year forecast period, the gap will be even smaller.

Why? A couple of reasons. One is that a large part of the current problem represents a hangover from the early years of this decade, when the state ran up big year-end deficits and then borrowed to cover the bills. It is a credit card balance. And that balance will soon be paid off. When it is, billions of dollars now going to repay that debt will be available to finance current services again.

Second, Hill forecasts that, once the housing market bottoms out and people start buying and building homes again, California's economy will be perkier. With the state's high-tech economy and its location as the gateway to the Pacific Rim, California will continue to capitalize on the boom in global trade. All of that economic activity should bring new jobs, retail sales, profits – and more tax revenue to the state's coffers.

Combined, the trends mean that the growth in revenues should outpace the growth in spending over the next five years, allowing those two trend lines to converge. By 2012, Hill projects, revenues should be in the neighborhood of \$133 billion, while spending is on a track to grow to \$135.5 billion. That's not balance, but it's a shortfall of only 1.8 percent.

To look at it another way, consider that by Hill's reckoning, state spending is projected to grow about 30 percent over the next five years. To bring the books back into balance, that spending growth must be limited to 28 percent instead.

If Hill is right, the implications are important for Schwarzenegger, for legislators and for every Californian who pays taxes or uses state services, which means all of us. As ugly as the short-term picture appears, the long-range problem remains manageable.

This gives Schwarzenegger a second chance to get right a problem he mishandled in his first year in office, after he was elected on a platform of quickly balancing the budget. Back then, Schwarzenegger agreed to a budget that made some short-term progress but did nothing to solve the long-term problem. And that is why he is back in this fix today.

But now, short-term solutions are mainly what the state needs, to get through the two-year rough patch ahead. Democrats in the Legislature will be eager to adopt such solutions rather than cutting more deeply into spending. Republican legislators will go along if it means avoiding a big tax increase. Schwarzenegger, in the middle, can exercise leadership by supporting that approach if and only if both sides also agree to adopt real, credible, long-term changes that will wipe out the persistent budget shortfalls once and for all.

And if they act wisely next year, lawmakers can do this without too much pain. While their short-term fixes (most likely leasing the state lottery to a private operator) cover the big gap looming around the corner, they can fix the long-term problem by adopting about \$4 billion in new revenues or spending cuts that could be phased in and take full effect three years from now.

Current lawmakers can't bind future legislators who have not yet been elected. But they can change laws that will affect spending or revenue trends into the future. And Schwarzenegger, whose term does not end until January 2011, can bind himself, by declaring that he will not sign a budget next year that does not fix the long-term problem he promised to solve as a candidate way back in 2003.

And this time, he should actually mean it.